EXHIBIT #1
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HB 608

HB 608
2011 Legislative Session
House State Administration Committee
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Roxanne M. Minnehan, Executive Director
Montana Public Employee Retirement Administration

HB 608 – Close Retirement Systems and Provide an Annuity Benefit Program

Introduction

- This bill closes the existing state public retirement systems to new members and creates an annuity benefit program ran by the Department of Administration.

- This bill impacts ALL the retirement plans administered by the Public Employees' Retirement Board (PERB) except for the VFCA. It impacts: PERS – both the Defined Benefit and Defined Contribution Retirement Plans, JRS, HPORS, SRS, GWPORS, MPORS, FURS. It also impacts the TRS.

- An annuity plan is a form of insurance. Annuity plans are offered by insurance companies. The premiums are paid through contributions. The insurance premiums appreciate over a fixed period of time until it matures. It then provides regular payments for the duration of the contract.

Disadvantages of Annuity Plans

- Fees paid to the insurance company eat into the profits.

- Annuities have relatively weak returns overall and they lack flexibility.

- Annuity plans are beneficial to the insurance company. Annuities are essentially a bet with an insurance company that the member will live long enough to make more from the annuity than the member paid in. Unfortunately, most lifetime annuity plans never come close to paying out their principal in full.

- A huge risk to this type of investing is failure of the insurance company. A very real concern.

- If the company enters bankruptcy, it is able to waive the requirements to pay off existing annuities unless that section of the business is purchased by another insurance company.

- Members will be seeking public assistance when they cannot sustain themselves in retirement from their annuity benefits.

- No retirement, death or disability benefit is provided under this proposal.

Time Required for Study

- Proposals of this sweeping change need time for research and development to study and determine the full impact, requirements and avoid unintended consequences.

- The SAVA Interim Committee is the Committee that vets proposed retirement bills. This bill was not vetted through SAVA.

- The 2009 Legislature passed HB 659 requiring an interim study the statewide retirement plans and providing an appropriation. An actuary was hired to evaluate several plan alternatives.

- ***SAVA did not propose closing the current defined benefit retirement plan and replacing it with an annuity benefit program.***

- SAVA did recommend the Board's proposals to address the UAL in PERS, GWPORS and SRS in HB 122, HB 134 & HB 135 to the legislature with a recommendation to remove the funding mechanism.

- ❖ This committee and the House have already passed those bills over to the Senate.

- ❖ HB 608 increases the normal cost in PERS to 14%. Current NC is 12.61%. HB 122 further decreases normal cost in the DB plan to 9.59% over time.

<u>The Advantages of Defined Benefit (DB) Plans</u>

- ❖ DB plans do not provide extravagant benefits. The average PERS retiree earns $1,049/month. <Refer to Green Sheets for all system averages>

- ❖ DB plans provide a guaranteed lifetime benefit at retirement based on a formula that reflects salary history and service.

- ❖ DB plans have been around for over 100 years because they have many positive attributes, especially in the current economic environment. Montana's Public Employees' Retirement System has been in place for 66 years.

- ❖ Traditional DB plans better ensure retirement security for employees and are a cost effective recruitment and retention tool for employers.

- ❖ DB plans are efficient. They:
    - o are inexpensive to administer
    - o have pooled risk
    - o are managed by investment professionals
    - o have diversified portfolios
    - o resulting in higher returns.

- ❖ The actuarial assumed rate of return of 7¾% is very realistic. It is an average over time. It is based on the investment allocation and objectives of the Board of Investments. FY 1994 – FY 2008, the average rate of return was 8.47%. The BOI's consultants reported in December 2010 that given the risk and return make-up of the portfolios, the average return expectation is 7.93% over time.

- Markets are improving.
  - FY 2010 rate of return – 12.87%.
  - FY 2011 through January 2011rate of return – 17½%.

Closing the Current Plans

- Closing the current PERS-DCRP may require an increase in fees to cover plan expenses.

- Closing the DB plans without funding the systems is in direct conflict with the Montana Constitution which states that actuarially required contributions shall not be diverted from the trust.

Constitution Language – Article VIII Section 15

Constitution of Montana

-- Article VIII -- REVENUE AND FINANCE

Section 15. Public retirement system assets. (1) Public retirement systems shall be funded on an actuarially sound basis. Public retirement system assets, including income and actuarially required contributions, shall not be encumbered, diverted, reduced, or terminated and shall be held in trust to provide benefits to participants and their beneficiaries and to defray administrative expenses.

(2) The governing boards of public retirement systems shall administer the system, including actuarial determinations, as fiduciaries of system participants and their beneficiaries.

History: En. Sec. 2, Const. Amend. No. 25, approved Nov. 8, 1994.

- Closing the DB plans without providing provisions for funding the current DB systems (eight in total), as proposed under HB 608 will exacerbate the current funding issues of all DB plans.

- ❖ Closing the current plans has a detrimental impact on the plans funding.

- ❖ Closing the DB plans does not reduce the unfunded actuarial liabilities (UAL) of the plans.

- ❖ A stable membership and income stream is needed to fund the DB plans.

- ❖ Since new hires will not be in the DB plan, the payroll base in all plans will begin to decline immediately. Less money will be available to pay down the UAL.

- ❖ A portion of every employer contribution goes to paying the UAL. This employer contribution to the DB plan is eliminated.

- ❖ The financial burden as a percent of payroll will increase.

- ❖ The investment returns will not be sufficient to pay *increasing* retirement benefits on a *declining* payroll.

- ❖ Because of the declining payroll. The current method of calculating the amortization payment will need to be changed to reflect a closed system. This will compound the cost of funding the DB UAL.

- ❖ The DB plans must continue to operate until that last new hire retires dies and the new hire's beneficiary dies. This will 75+ years into the future.

- ❖ If this bill goes further in the process we would like the opportunity to amend the fiscal note as we will need to seek information from our consultants re: further implications of this proposal from our tax attorneys and actuary.

❖ The actuary determines the impact to the plans. We did not request an actuarial study on all the plans because the cost of actuarial studies on every proposal costs between $1500 and $3500 per retirement plan. If this bill goes forward, we would request an actuarial impact study for each retirement system to prepare an updated fiscal note.

❖ The impact to the PERS plan addressed in the fiscal note was determined from an impact study prepared for another bill.

<u>PERS-DBRP funding example</u>

- Payroll decreases from $1.15B to $0.31B in 2030.
- Funding status plummets from 74% today to 7% in 2030.
- Actuarial Accrued Liability (AAL) increases from 5.24B to 8.65B in 2030
- Annual required contributions (ARC) increase from 22.3% today to 223.5% in 2030.

❖ All 6 other plans administered by the Board will have the same results:

- Payrolls will decrease.
- Funding statuses will plummet.
- AAL will steadily increase.
- ARC will dramatically increase.

❖ **The funds will run out of money; creating a much deeper hole than we are in today. <Handout – PERS Assets vs. Liabilities>**

<u>HB 608 Technical Concerns</u>

❖ Section 1 – speaks of "earliest date… first hired .. in a covered position" – does this mean any public retirement system covered position (meaning across plans) or is it limited within a retirement plan?

❖ The bill does not address the funding issue that exists today in the PERS, GWPORS and SRS. A funding issue that becomes exacerbated by closing the plans. Nor does it address the funding issues caused by closing the other defined benefit plans.

- ARC is needed to continue to pay the employer's unfunded liability obligation to the DB plans.

- Cost to provide plan education to employees and employers is not addressed in the bill. Over 530 local government employers may contract for with the State of Montana to participate in the program.

- This will also be a cost to those local governments. As well as the cost to their human resources/payroll systems to allow for these contributions.

- The initial appropriation does not address ongoing administrative costs.

Closing

- **With this bill the DB plans go broke long before the last benefits are paid out.**

- The Public Employees' Retirement Board respectfully recommends a "Do NOT Pass" on HB 608.

- I will remain available for questions.

- Thank you.